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IN THE

Supreme Court of the United States

OCTOBER TERM, A. D. 1941.

No. 212

FRED BARNETT AND EDNA M. BARNETT,
Petitioners,

vs.

RECONSTRUCTION FINANCE CORPORATION,
A CORPORATION,
Respondent.

PETITION FOR WRIT OF CERTIORARI AND BRIEF IN SUPPORT THEREOF.

DOMINIC P. SEVALD,
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SUMMARY OF THE ARGUMENT.

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RECONSTRUCTION FINANCE CORPORATION,
A CORPORATION,
Respondent.

PETITION FOR WRIT OF CERTIORARI, AND BRIEF IN SUPPORT THEREOF.

To the Honorable, the Supreme Court of the United States:

Fred Barnett and Edna M. Barnett, for their Petition for a Writ of Certiorari to the United States Circuit Court of Appeals for the Seventh Circuit, respectfully set forth and represent to this Honorable Court the following:

SUMMARY STATEMENT OF THE MATTER INVOLVED.

The Reconstruction Finance Corporation, respondent, as plaintiff, filed this action in the United States District Court, for the Northern District of Indiana, Hammond Division, against petitioners, Fred Barnett and Edna M. Barnett, on January 20, 1938, to recover upon a

promissory note for $5400.00 and to foreclose a real estate mortgage given to secure payment of the note. On April 15, 1940, the district court rendered judgment for defendants and against the plaintiff (R. 98).

On appeal by the Reconstruction Finance Corporation to the United States Circuit Court of Appeals, for the Seventh Circuit, the judgment of the trial court was reversed on February 5, 1941 (R. 122), (*R. F. C.* v. *Barnett, et al.*, 118 F. (2d) 190). Thereafter on February 19, these petitioners filed their Petition for a Rehearing, and which was overruled and denied on March 27, 1941 (R. 137).

The present action is the third one brought to recover on this note and mortgage. The first was filed April 30, 1931, in the Superior Court of Lake County, Indiana, (at Hammond), by the Chicago Trust Company, the original owner of these securities, against Fred Barnett and Edna M. Barnett, these petitioners, and others. After a change of venue was taken from that court to the Circuit Court of Porter County, Indiana (Valparaiso) a judgment of foreclosure was there rendered on October 14, 1932, in favor of the Central Republic Bank and Trust Company, which had been substituted as plaintiff, and against these petitioners as defendants. From this judgment these petitioners perfected an appeal to the Appellate Court of Indiana, where on June 15, 1935, the judgment of the trial court was reversed. (*Barnett* v. *Central Republic Bank and Trust Company*, 100 Ind. App. 495, 196 N. E. 369.)

In that action these defendants as a part of their answer set forth that the Chicago Trust Company was an Illinois Corporation, and never at any time obtained a license to transact its corporate business as a foreign corporation in the State of Indiana, as required by Burn's R. S. Ind. 1926, Secs. 4909, 4910, 4913, 4918 and 4923. (See Appendix, pp. 49-51.) Further, that it did nevertheless in violation of this statute maintain an office in Ham-

mond, where among numerous others, it solicited and granted the loan evidenced by the note and mortgage in question, and through said office carried on all the necessary negotiations to complete such loan, including the signing and delivery there by these defendants of the note and mortgage, together with all other documents included in the transaction, and filed this mortgage for record in the recorder's office of said Lake County, thereby invoking and obtaining the protection of the Indiana recording laws (R. 32).

This foreign corporation act required an applicant to file certain documents in the office of the Secretary of State, to maintain a local office in the state, to pay the required license fee, and appoint a qualified domiciled agent in the state upon whom service of legal process could be made, etc. For a violation of these provisions, the offender was made subject to a fine, its business in the state could be stopped, and it was denied the use of the state courts to enforce its legal actions until it complies with the act. The Chicago Trust Company, while the owner of these securities, became insolvent surrendered its corporate charter, and was, with another company, merged into a new corporation known as the Central Republic Bank and Trust Company, and that by reason of its insolvency and dissolution reached a status where it could not thereafter comply with such foreign corporation act, and whereby it was barred from a recovery on this note and mortgage; that the Central Republic obtained title to these securities by virtue of such merger.

All these facts were set forth in this answer, and to it the plaintiff filed a motion to strike out this paragraph of such answer. This motion was sustained by the trial court, and for this error the Appellate Court reversed the judgment, holding that this part of the answer set forth a good defense, and if proven would operate as a complete bar to the action. On remand of this case back to the trial

court, the plaintiff voluntarily dismissed its complaint on November 30, 1937, and the cause is still pending undetermined there on petitioners' cross-complaint (91). For convenience, we will hereinafter refer to this action as the "State Court Case."

The Appellate Court of Indiana is a court of appeals and review of judgments of the trial courts. Its decisions are final, excepting and unless, after a petition for rehearing is filed within the prescribed time and overruled, a petition is thereafter timely filed in the Supreme Court for a transfer of the cause to the latter court and such transfer granted. No petition for a rehearing was filed in this appeal; neither was a petition for transfer filed, consequently the opinion and judgment of the Appellate Court is final. (Burn's R. S. Ind., 1933, Secs. 4-214 and 4-215.)

The second action to recover on this note and mortgage was filed by the Central Republic Bank and Trust Company, as plaintiff, against these petitioners and others, as defendants, on March 14, 1932, in the United States District Court below. It was voluntarily dismissed by that plaintiff on October 21, 1932, one week after the same plaintiff obtained its judgment in the state court case in the Porter Circuit Court (R. 92).

In the present case we plead in our answer the voluntary dismissal of these two former actions as an adjudication on the merits of the issues involved, as provided by Rule 41-(i) of the rules governing civil procedure in the District Courts, effective September 18, 1938. But since this effective date was subsequent to the date of filing the present action below, the Circuit Court below held it did not apply herein. (Opn. Cir. Ct., R. 123 and Appendix, p. 39.)

The material and important facts and issues herein, as disclosed by the complaint, our answer, and the evidence as contained in the special finding of facts made by the trial

court below, show that on February 18, 1927, petitioner Edna M. Barnett was the sole owner in fee of Lots 54 and 55, in Block 7, in Homewood Addition to the city of Hammond, Lake County, Indiana, improved by a dwelling house, the same then and now occupied by her and her family as their dwelling. On this day she and her husband, petitioner Fred Barnett, executed their promissory note for $5400.00 payable to the order of themselves and by them endorsed and delivered to the Chicago Trust Company. This note was made payable on the semi-annual installment plan as to principal and interest, beginning February 1, 1928, with a final payment of $615.00 on the principal due August 1, 1942.

They secured the payment of this note, by executing their mortgage on this real estate to the Chicago Trust Company and Willard F. Hopkins as trustees. Default having been made by petitioners in the payment of installments on the note, the respondent, who claims to hold the securities by an assignment or pledge, from the Central Republic, filed this present action to recover on the note and to foreclose this mortgage. Issues were joined between the plaintiff and other defendants. A second mortgage due the Receiver of the Hammond National Bank & Trust Co., a defendant below having been paid during the pendency of this suit, and the issues as to other defendants having become immaterial, they need no further mention.

The complaint filed below states in substance the execution of the mortgage by petitioners, as set out above, that there was default in the payment as contained in the covenants of the mortgage. For its ownership of the securities, plaintiff says that the Chicago Trust Company, the original mortgagee, was merged into and with the Central Republic Bank and Trust Company. That thereafter the Central Republic became indebted to plaintiff for $30,000,000.00; and that it received from the Central Republic the note and mortgage in question, among other

assets, as a pledge to secure said indebtedness; and that it brings the present action as pledgee of said securities.

A further allegation recites that in April, 1931, a former action was brought, based upon the same note and mortgage, by its original holder, Chicago Trust Company, against petitioners and others to foreclose the same mortgage. That after substitution of the plaintiff in said cause and while the action was pending in the state court, the defendants, these petitioners, filed an answer alleging in substance that the Chicago Trust Company was an Illinois corporation and was doing business in the State of Indiana without having first obtained a license to do so as a foreign corporation, and that under the laws of the State of Indiana such corporation was denied the right to resort to the courts of said state to enforce its action. That said mortgage and note were valid contracts, but not enforceable in the state courts of Indiana, and that neither of the parties to said action could obtain any relief in the state courts (R. 8).

In the present action these petitioners filed practically the same answer as in the State court case, setting forth in substance the foregoing statements relative to the noncompliance by the former plaintiff with the Indiana Foreign Corporation Act, and stating with more particularity that petitioners applied for this loan and signed all papers necessary in and about obtaining it including the note and mortgage in question, at an office which the Chicago Trust Co. at the time unlawfully maintained in the City of Hammond, Lake County, Indiana, and where all the details of the transaction were carried on, and to all effects the contract in question was an Indiana contract.

It is also alleged that the mortgagee recorded its mortgage in the recorder's office of Lake County, Indiana, where it obtained and received the benefit and protection afforded by the recording laws of Indiana. Further, it is alleged that while the Chicago Trust Company was the

owner of these securities, it became insolvent, ceased to function as a corporation, surrendered its corporate charter and was thereafter merged and consolidated with another Illinois corporation newly created. The name for both being given a new name, Central Republic Bank and Trust Company, and that by reason of the former's insolvency and nonexistence, it cannot comply with such foreign corporation act.

This answer further recites all the foregoing facts relative to the proceedings in the state court case, asserting that the ruling laid down by the Appellate Court opinion in reversing the trial court's judgment became the law of the case; and further, that by plaintiff's voluntary dismissal of its complaint, after the remand, constituted an adjudication of the issues involved (R. 32-40 and 44-45).

Finding No. 8 of the special findings of fact (R. 85) sets out the opinion of the Appellate Court of Indiana in the state court case, and which is set forth in the record (R. 86). In this opinion the question was whether our paragraph of answer pleading noncompliance of the foreign corporation act was a plea in bar, and if it were such the trial court erred in striking it out, as it is held in Indiana that where a corporation has reached a state that prevents its compliance with the statute, such noncompliance may be pleaded in bar. It quotes from our answer:

> "Chicago Trust Company had been consolidated into and with, and had ceased to do business as a corporation, and its assets and affairs have been taken over by the plaintiff herein, The Central Republic Bank and Trust Company * * * that said Chicago Trust Company has ceased to function and operate as a corporation, and that it therefore cannot now comply with the foreign corporation act of Indiana."

The court then cites the leading cases of Indiana to the effect that such plea is one in bar and that this is also true where the successor in title to the original mortgage

was either an assignee or receiver. The answer sets up its noncompliance as a defense, and further sets out the facts relative to the appeal and reversal in the state court case, wherein the Appellate Court again declared the law construing this foreign corporation act.

The Circuit Court of Appeals below held that it was not so much a question whether the Indiana statutes and decisions forbade recovery on the contract,—that while recovery might not be had in the state court, such was no bar to a recovery in the federal court, holding that the contract was legal, and this notwithstanding the fact that the Appellate Court of Indiana had passed upon the very same question upon the same note and mortgage. The facts of the noncompliance by the Chicago Trust Co. with the Indiana foreign corporation act and its inability to recover in the state court were admitted in plaintiff's complaint (R. 8); likewise such is also contained in the trial court's special findings of facts (R. 68 and 90). The case at bar was decided upon the authority of *Metropolitan Life Insurance Co.* v. *Kane,* (117 F. (2d) 398, 7th Cir. Jan. 30, 1941), which case the court stated differed only in one slight particular from the present case, but with which statement we do not agree. Decidedly the Kane case was presented in a manner quite different from this one. The Circuit Court below conceded it was bound to follow the Indiana courts on their construction and application of this foreign corporation act, but evaded the issues we presented by asserting that the decision in *Peter and Burghard Stone Co.* v. *Carper,* 96 Ind. App. 554, 172 N. E. 313 (1933), is the last and true pronouncement by the state courts on this question, and the one to be recognized and followed. In this the Circuit Court is in error, as the Stone Co. case dealt with only the contract rights of a live corporation which did, before it filed its action, register as a foreign corporation, whereby all these restrictions imposed upon its corporate activities were removed. There

the status of a contract made by a noncomplying corporation, which afterwards went out of existence, was not in question. Apparently the Circuit Court below was impressed by the fact that the Stone Co. decision expressly overruled *U. S. Construction Co.* v. *Hamilton National Bank,* 73 Ind. App. 149, 126 N. E. 866 (1919), in which latter case it was held that contracts made by a noncomplying corporation were void, without regard to a later compliance with the act. As we consider the reasoning of the court below in the Kane case not well founded, we discuss that case more fully in our brief and argument presented herewith.

Another point we strenuously urged before the Circuit Court, but to no avail, was the effect of the Indiana Appellate Court decision. We asserted that the trial and judgment in the state court case, followed by our appeal and reversal, became the law of the case, to be thereafter followed by any court, federal or state, on a retrial of the same issues.

JURISDICTION.

Plaintiff-Respondent, the Reconstruction Finance Corporation, being a federal governmental agency, as created by U. S. C. A., Sections 601-17, invoked the jurisdiction of the District Court below by virtue of Section 24 of the Judicial Code (U. S. C. A., Secs. 41-42), the amount involved exclusive of costs being in excess of $3,000.00, with a further showing that these defendants-petitioners were residents and citizens of Indiana, that the residence of the other defendants were properly shown, and that the land involved is situated in Indiana, and all as particularly shown in its complaint.

The Circuit Court of Appeals below assumed jurisdiction on appeal from the District Court, for the Northern District of Indiana, Hammond Division, under Section 128 Judicial Code (U. S. C. A., Sec. 225 A-1).

We assert this court is given jurisdiction to hear and determine our Petition for Certiorari by authority of Section 240 Judicial Code (U. S. C. A., Sec. 347-(a)), and as further provided for under Sub. Sec. 5-b of Rule 38, of the rules of this court, as adopted February 13, 1939.

QUESTIONS PRESENTED.

I.

Was it not the duty of the United States Circuit Court of Appeals for the Seventh Circuit to have followed the Indiana law, by holding that a recovery could not be had on the note and mortgage, where the original holder at the time these securities were taken and accepted by it, was unlawfully transacting its corporate business in Indiana, and then while so holding them became insolvent, ceased to exist, and thereby placed itself in a situation whereby it could never thereafter comply with this foreign corporation act. This is the law of Indiana as declared in its court decisions hereinafter referred to.

This question has been fully determined by this court in *Erie R. R. Co.* v. *Tompkins*, 304 U. S. 64, 82 L. ed. 787, (1938) holding it is the duty of the federal courts to follow and apply the state statutes and decisions where no federal statute or question is involved. *Swift* v. *Tyson*, 16 Peters 1 (1842), is expressly overruled, and since the Erie case decision numerous like ones have been made by this court, some of which we recite in our supporting brief contained herein.

II.

The Circuit Court of Appeals for the Seventh Circuit incorrectly interpreted the decisions of the Indiana Supreme and Appellate Courts in construing this foreign corporation law. All these decisions make a clear distinction between the rights of a live corporation and those of one that has ceased to exist. The former may still comply with the act, and then enforce its action in the state court while the latter being in no position to comply has forfeited all its rights, and they are thereby forever barred.

Then if these state courts have clearly defined this distinction, was it not the duty of the Circuit Court below to have pronounced its decision in conformity therewith?

III.

Was the Circuit Court of Appeals for the Seventh Circuit justified in holding as a matter of law, that even if the state courts barred recovery, plaintiff nevertheless could enforce its action in the federal court?

IV.

The decision of the Indiana Appellate Court in *Barnett* v. *Central Republic Bank & Trust Co.*, 100 Ind. App. 495, reversing the judgment rendered in the Porter Circuit Court became and is the law of the case, which must be followed on a retrial or on a second appeal. Therefore was it not the duty of the Circuit Court below to have followed and applied the law as laid down in this decision?

V.

Two former actions filed to recover on the same and identical securities having been voluntarily dismissed by the plaintiffs therein prior to the time the present action was filed, do not such dismissals operate as an adjudication of the issues on the merits, as prescribed by Rule 41-(i) and Rule 86, of the rules of civil procedure for the District Courts of the United States (effective September 18, 1938)?

REASONS RELIED UPON FOR ISSUANCE OF WRIT.

1. The Circuit Court of Appeals for the Seventh Circuit has decided an important question of local law and of widespread general interest in a way directly in conflict with the applicable local decisions of the state courts of Indiana, and in a manner having no support whatsover in judicial precedent.

We refer to its action in refusing to follow the Indiana law and the construction of its courts placed upon its foreign corporation act, in that it refused to recognize and adopt the decisions of such state courts placing the true constructions on such act.

2. Likewise the Circuit Court of Appeals for the Seventh Circuit has rendered a decision in this case on an important question of local law directly in conflict with the decisions of several other circuit courts of appeals, on the question of the duty of a federal court to follow and apply the local state law, in cases wherein no federal statute or question was involved, and in particular in the cases and in the circuits following, to-wit:

(a) Fourth Circuit:

Allison v. *Gt. Atl. & Pac. Tea Co.* (1938), 99 Fed. (2) 507.

Coca-Cola Bottling Co., etc. v. *Munn* (1938), 99 Fed. (2) 190.

(b) Fifth Circuit:

Terrell v. *Gary* (1938), 98 F. (2) 14.

Eppenhauer v. *Ohio Oil Co.* (1938), 524.

(c) Sixth Circuit:

McCrate v. *Morgan Packing Co.* (1941), 117 F. (2) 702.

Consolidated Coal Co. (1940), 113 F. (2) 813.

(d) Eighth Circuit:

Ft. Dodge Hotel Co. (1941), 119 F. (2d) 253.

Yoder v. *Nu-Enamel Corp.* (1941), 117 F. (2) 488.

(e) And in conflict with decisions in its own circuit, among them:

Gorney v. *Trustees, etc., Orphans' Board* (1937), 93 F. (2) 107.

Toomey v. *Toomey* (1938), 98 F. (2) 736.

3. The Circuit Court of Appeals for the Seventh Circuit has so far departed from the accepted and usual course of judicial proceedings as to call for an exercise of this court's power of supervision, in that (a) the opinion in the present case holds that the dismissals of the two former actions brought upon these same securities does not constitute an adjudication upon the merits of such issues, as provided by Rule 41, a-1, in conjunction with Rule 86, of the rules of civil procedure in the District Courts, and (b) by conceding it is its duty to follow the State statutes and decisions, but then holding it is governed by other decisions of the state courts, which are not in fact the true interpretation of the law relative to the matter in question.

As a more ready and convenient reference, we affix hereto an appendix, containing the pertinent sections of the Indiana statutes governing foreign corporations for the period of time in question, the opinion of the Circuit Court below rendered in the present case, and the same court's opinion in the Kane case, excepting the part thereof dealing with questions not in point herein. This latter opinion is appended for the reason the court made its decision in our case upon its authority.

A duly certified transcript of the record of this cause, as filed in the United States Circuit Court of Appeals for

the Seventh Circuit, together with a certified copy of the essential proceedings in, and the disposition made by that court of this action, is furnished and lodged in the office of the Clerk of this Court in compliance with Rule 38 of the rules of this court, concurrently with the filing of this petition, and all done within three months from March 27, 1941, the date our petition for a rehearing in this cause was overruled by the Circuit Court below (R. 137).

Wherefore, your petitioners respectfully pray that a writ of certiorari be issued out of, and under the seal of this court, directed to the United States Circuit Court of Appeals for the Seventh Circuit, commanding it to certify and to send to this court, for its review and determination, a full and complete transcript of the record and all the proceedings had and determined in the cause numbered and entitled on its docket as Number 7455, *Reconstruction Finance Corporation, a corporation, Appellant,* v. *Fred Barnett, et al., Appellees;* and thereupon that the said opinion and judgment of the United States Circuit Court of Appeals for the Seventh Circuit may be in all things reversed and set aside by this Honorable Court. And your petitioners also pray for such other and further relief in the premises which the court may deem meet and just.

FRED BARNETT and
EDNA M. BARNETT,
Petitioners,

By DOMINIC P. SEVALD,
FRED BARNETT, and
JESSE W. MCATEE,
Their Counsel.